LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS
301 State House
(317) 232-9855

FISCAL IMPACT STATEMENT

LS 7462 **DATE PREPARED:** Feb 3, 1999
BILL NUMBER: SB 649 **BILL AMENDED:**

SUBJECT: Tax abatement; research and development incentives.

FISCAL ANALYST: Bob Sigalow, Diane Powers, Jim Mundt
PHONE NUMBER: 232-9859, 232-9853, 232-9858

FUNDS AFFECTED: X GENERAL **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *Abatement period*: This bill provides that property tax abatement deductions may be granted for any number of years less than or equal to ten years. (Current law limits the abatement deduction to three, six, or ten years for real property and five or ten years for personal property.)

Research & development abatement: The bill provides that certain research and development equipment is eligible for property tax abatement deductions. It allows the abatement deduction for research and development equipment only if the equipment is used in a research and development facility engaged in activities devoted directly and exclusively to experimental or laboratory research and development for new products, new uses of existing products, or the improvement or testing of existing products.

Research & development sales tax exemption: This bill also provides an exemption from sales and use tax for research and development equipment and for property and utility services consumed in research and development.

Research & development income tax credit: This bill modifies the research expense tax credit against gross income taxes and adjusted gross income taxes based on the taxpayer's Indiana qualified research expenses rather than the lesser of its Indiana qualified research expenses or its apportioned research expenses for the year. It also makes the research expense tax credit permanent by eliminating its expiration date.

Effective Date: July 1, 1999; January 1, 2000.

Explanation of State Expenditures: *Abatement period*: The State Tax Board processes the personal property abatement forms and certifies the amount of assessed value (AV) to be abated to the county auditor. The Tax Board would need to alter the computer programs that process these forms because of the option to grant abatements from one to ten years in duration. The Tax Board should be able to complete this task with current resources.

Explanation of State Revenues: *Research & development abatement*: The State levies a one cent tax rate on property for State Fair and State Forestry. Any change in the amount granted for abatements would change the amount received from this tax.

As explained below in Local Revenues, if there is an increase in development because of this proposal, the new property would, at some point, be placed on the tax rolls and the State Fair and State Forestry funds would receive increased revenues. If the investment would be made with or without the abatement then increased revenues to the State Fair and State Forestry funds would be foregone until the property is placed on the tax rolls.

Research & development sales tax exemption: This bill will result in a reduction in revenue from the sales and use tax. It provides an exemption for the purchase of equipment which will be directly used in direct research and development. It also provides an exemption for the purchase of tangible personal property which will be directly consumed in direct research and development. Based on national statistics of research and development expenditures and information adjusted for Indiana based companies that purchase research and development equipment and consumables, it is preliminarily estimated that the annual loss of revenue will range between $49 million and $91 million.

Gross retail (sales) and use taxes are deposited in the State General Fund (59.2%), the Property Tax Replacement Fund (40%), the Public Mass Transportation Fund (0.76%), and the Industrial Rail Service Loan Fund (0.04%).

(Revised) *Research & development income tax credit*: This bill modifies the research expense tax credit against gross income taxes and adjusted gross income taxes based on the taxpayer's Indiana qualified research expenses rather than the lesser of its Indiana qualified research expenses or its apportioned research expenses for the year. This change is effective for tax years beginning January 1, 2000. Currently only businesses who do not have income apportioned to the state for a taxable year may calculate their credit based on only Indiana research expenses. The current research development credit is equal 5% of their qualified expenses minus their base year amount. For FY 97 there were approximately $15.3 M of tax credits claimed.

This change would benefit Indiana domiciled companies who conduct a significant amount of their research in Indiana, but have an apportionment factor for income earned in Indiana that is less than the percentage of their overall research expenses which are conducted in the state. This bill will allow all companies to compute their tax credit based on only the amount of research conducted in the state.

It is unknown how many Indiana businesses would be affected by this change. This modification could increase the amount of research and development credits taken by approximately $5.2 M annually beginning in FY 2001. However with additional incentives created for research and development activity based in the state of Indiana, this credit could increase by an indeterminable amount. The research and development tax credit affects revenue collections deposited in the General Fund and Property Tax Relief Fund.

This bill also makes the research expense tax credit permanent by eliminating its expiration date. This credit was currently set to expire on December 31, 1999.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Abatement period*: Currently, real property may be abated for 3, 6, or 10 years and personal property may be abated for 5 or 10 years. The length of abatement, within the above constraints, is left up to the local designating body. This proposal would allow the local designating body to determine the number of years, from one to ten, that a real property or personal property ERA may be granted.

While giving the local designating bodies more options as to the length of the deduction might produce overall shorter abatement periods for new abatements, it could also encourage an increase in the number of abatements granted. This is because sometimes a designating body might be reluctant to allow a long abatement period for a small project. This provision allows a shorter, possibly more equitable, alternative. Therefore, it could be concluded that, overall, this provision may have a minimal effect on the total amount of tax shift due to ERAs.

Research & development abatement: In addition to the types of property that may currently qualify for abatements, this bill would allow abatements for "new research and development equipment". The equipment could consist of laboratory equipment, R&D equipment, computers, telecommunications equipment, or testing equipment. The equipment must be used in an R&D facility that is used exclusively for R&D of new products, new uses of existing products, or the improvement or testing of new products. Facilities used for efficiency surveys, management studies, consumer and economic surveys, advertising or promotion, and research on literacy or history projects would not qualify for an abatement under this provision. According to the bill, a facility does not have to be in a separate building to qualify as an R&D facility.

If there is an increase in development because of this proposal, the new property would, at some point, be placed on the tax rolls. This could help spread the property tax burden and could possibly reduce some tax rates. However, if one assumes that the investment would be made with or without the abatement, an increase in abatements (ERAs) could also cause a delay of the shift of the property tax burden from all taxpayers to the owners of the new property until the property is placed on the tax rolls.

State Agencies Affected: State Board of Tax Commissioners; Department of Commerce.

Local Agencies Affected: County auditors; Local designating bodies; Counties; Municipalities.

Information Sources: National Science Foundation; Department of Revenue.